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Supreme Court of the United States

October Term 1962

Nos. 5951-5952-5953

HERMETIC SEAL PRODUCTS COMPANY, P. R.,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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The petitioner prays that a writ of certiorari issue to review two judgments of the United States Court of Appeals for the First Circuit entered in the above case on August 30, 1962 and a third judgment entered on November 13, 1962 in three cases which were consolidated by the District Court and treated as one by the Circuit Court in its opinion dated August 30, 1962.

Opinions Below

The opinion of the District Court for the District of Puerto Rico (R. 49) is reported at 198 F. Supp. 749. The opinion of the Court of Appeals for the First Circuit is reported at 307 F. 2d 809. On motion by the Respondent, the Court of Appeals vacated one of the judgments entered on August 30, 1962 and entered a judgment of affirmance on November 13, 1962. The opinion of the Court of Appeals rendered on November 13, 1962, not yet officially reported, is set forth at page 9a of the Appendix to this Petition.

Jurisdiction

Copies of the judgments of the Court of Appeals for the First Circuit are appended to this petition in the Appendix at pages 4a to 8a. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

Questions Presented

In three actions at law the respondent sought to recover from the petitioner in the District Court for the District of Puerto Rico excess profits on defense sub-contracts as determined in three unilateral orders of the Renegotiation Board. The fiscal years involved ended July 31, 1952, July 31, 1953, July 31, 1954 and July 31, 1955. In the District Court the petitioner pleaded that the renegotiation claims of the United States were barred by its failure to assert them in a certain arrangement proceeding under Chapter XI of the Bankruptcy Act in the United States District Court for the District of New Jersey which involved the petitioner and affiliated corporations, which was commenced in August, 1956. The Renegotiation Board was not then listed as a creditor by this petitioner. It was also urged upon the District Court that the Renegotiation Act did not apply to the petitioner's business in Puerto Rico. That Court refused to pass upon the question of the applicability of the Renegotiation Act and held that the claims in suit were not discharged by the arrangement proceedings even though the respondent was a party to those proceedings, filed a claim therein and had 24 days notice of the promulgation of the plan prior to its confirmation. The District Court accordingly entered three judgments for the respondent in the respective amounts of $650,000, $225,000 and $100,000 with interest at 4%. The Court of Appeals of the First Circuit affirmed but stayed execution of the $650,000 judgment pending a determination by the Tax Court on the question of the applicability of the Renegotiation Act.

The questions presented are the following:

1. When the Renegotiation Board learned of the pendency of the Chapter XI proceedings on October 19, 1956 was that actual knowledge sufficient under Section 17, Ch. III, 11 USC 35 and under the rule established by this Court in *Birkett* v. *Columbia Bank*, 195 U. S. 345, 350? The plan

which was ultimately approved on November 13, 1956 had not yet been formulated by October 19. The question is therefore, whether such knowledge, obtained 24 days prior to the confirmation of the amended plan of arrangement was sufficient to afford the respondent an opportunity to appear in the proceedings and assert its claim before the plan was approved. If it was, the claims in suit were discharged.

2. Whether the respondent was under a duty to prevent the consummation of the plan by advising the Receiver or Referee of its claims when in November, 1956 it learned of its confirmation since, concededly, under the order confirming the plan no distribution of the monies deposited with the Court amounting to over $262,000 was actually made until March, 1957.

3. Since the respondent's claim as actually filed in the arrangement proceedings was broad enough in terms to encompass the claims in suit, was the respondent under a duty to seek relief in the arrangement proceedings rather than through the medium of these independent actions?

4. Whether the respondent is estopped from asserting its claims because, with knowledge of its claims, it sat by and permitted the investment of over $262,000 of fresh money under the plan of reorganization and accepted payment of a part of its claim under the plan as promulgated.

5. Whether the Renegotiation Act of 1951 applied to Puerto Rico or to this defendant and whether the District Court had the power to examine that question of jurisdiction.

Statutes, Federal Rules and Regulations Involved

The Bankruptcy Act, 30 Stat. 545, as amended (11 USC 1, et seq.):

Section 17, Ch. III, 11 USC 35(a) *1a

Section 58, Ch. VI, 11 USC 94(e) 1a

Section 367, Ch. XI, 11 USC 767 ..... 1a

Section 371, Ch. XI, 11 USC 771 ..... 2a

The Renegotiation Act of 1951, Ch. 15, 65 Stat. 7, as amended (50 U. S. C. App. 1211, et seq.):

Section 106, 50 USC App. 1216(d) 2a

Section 108, 50 USC App. 1218 ..... 2a

Second Organic Act, Sec. 9, 39 Stat. 954, as amended, (48 USC 734) 3a

Regulations of the Renegotiation Board

Section 1455.2(b), 32 C. F. R. 1455.2(b) 3a

The above statutes and Federal Regulations are set forth in the Appendix to this Petition at the pages indicated above.

Statement

These suits arise out of claims by the respondent for alleged excessive profits determined by the Renegotiation Board for the fiscal years ending July 31, 1952, July 31, 1953, July 31, 1954 and July 31, 1955. Three actions were commenced to recover those profits (R. 14, 28, 37). The first action sought recovery for the fiscal year ending July 31, 1952 and July 31, 1953. The amount sought was $650,000.

* Refer to pages of the Appendix to this Petition.

In the second, brought for the fiscal year ending July 31, 1954, $225,000 was sought, and in the third, for the fiscal year ending July 31, 1955, $100,000 was sought. Recovery was granted to the respondent in each action (R. 52, 53). In the first action the respondent moved for summary judgment. That motion was denied. Thereafter, the trial of that action was held on April 24 and 25, 1961. At the same time motions for summary judgment in the other two actions were heard. The three were consolidated so that the evidence adduced on the trial in the first brought action was deemed part of the record on the motions for summary judgments in the other two actions.

The petitioner is a corporation organized under the laws of Puerto Rico (R. 66). In a stipulation made in this very case on March 22, 1960 by the Attorney General of the United States with counsel for the petitioner it was expressly stipulated: "At all times material herein, defendant's principal office and place of business was at Rio Piedras, Puerto Rico" (R. 66). The statement made in the opinion of the Court of Appeals to the contrary is clearly inaccurate and represents an oversight.

Petitioner was engaged in the business of manufacture and assembly of hermetically sealed glass-metal components of electronic equipment such as thermostats, crystals, relays, condensers, transformers and tubes in Puerto Rico (R. 66). It had no direct dealings with the Government. It was conceded at the trial that it manufactured only for other persons or firms that sold to private industry and the Government, through the Department of the Navy. It was one of a group of affiliated corporations that on August 8, 1956 filed a petition for an arrangement under Chapter XI of the Bankruptcy Act in the District Court for the District of New Jersey. A hearing on a proposed plan of arrangement was held on November 9, 1956 at which the U. S. Attorney appeared and filed a claim on behalf of the plaintiff which was broad enough to encompass all the claims presently

in suit even though that U. S. Attorney was not actually aware of the full amount of those claims at that time. The claim as filed recited that "the above named bankrupt was at and before the filing of the petition for arrangement under Chapter XI of the Bankruptcy Act, as amended, and still is justly and truly indebted to the United States in the principal sum of at least $12,000 together with interest from September 15, 1956 at the rate of 4%" (R. 23, Exh. 47). It also recited in paragraph 3 of that claim that the consideration for the debt "is profits which have been derived under Government contracts subject to the Renegotiation Act of 1951."

A Receiver was appointed by the Court in August 1956 in the Chapter XI proceeding who assumed management and control of the corporation's affairs with the aid of counsel and Court appointed accountants. Simultaneously, the case was referred to a Referee in Bankruptcy. The petitioner herein did not set forth in its statement of affairs on August 8, 1956, at the time of the filing of its petition referred to, any contingent claim for renegotiation. However, on October 19, 1956 the Court appointed accountants—Besser & Co.—advised the Receiver and the Referee in a formal, filed, written report of all the possible liabilities of the debtor-corporations, including the petitioner herein. That report clearly indicated a contingent liability of the petitioner in connection with "Renegotiation of contracts performed subsequent to December 31, 1952 by domestic corporations" and "Renegotiation of all contracts performed by Hermetic Seal Products Company, P. R." in an indeterminate amount (R. 64).

On that same date, October 19, 1956, it is conceded that the Renegotiation Board learned through one Klebanoff, a former officer and principal stockholder of the petitioner, of the pendency of the Chapter XI proceedings (Supp. R. 137). A representative of the New York office of the Renegotiation Board immediately confirmed that fact by a

telephone call to the office of the Clerk of the District Court (Supp. R. 136). On the same day the Regional Board in New York notified Washington which in turn requested the General Accounting Office to prepare a proof of claim.

In the meantime, to protect its rights, the Regional Board on October 23, 1956 issued a unilateral order in the sum of $200,000 for the petitioner's 1952 fiscal year and on November 7, 1956 issued a unilateral order for the fiscal year ending July 31, 1953, in the amount of $300,000. No notice of these unilateral orders was ever given by the Renegotiation Board to the Receiver or the Referee.

It is indisputable that if the Renegotiation Board had examined the filed papers in the arrangement proceedings as soon as it learned of their pendency on October 19, 1956 and had at once communicated with the Receiver and the attorneys for the Creditors' Committee, the Renegotiation Board would have had full and equal opportunity with all of the other creditors to participate in the administration of the affairs of the estate and the dividends to be declared within the rule of the *Birkett* case. The reason for this is quite clear and appears at pages 251 to 255 of the Government's appendix in the Circuit Court which consists of the affidavit of the attorneys for the Creditors' Committee in the Chapter XI proceedings. That affidavit establishes that the report of the accountants appointed by the Court (the Besser report) was filed in Court on October 19, and indicated the existence of the renegotiation claims against the petitioner in an indeterminate amount. That report was studied by the Creditors' Committee on October 20 and 21, 1956. If the Renegotiation Board had promptly advised the Creditors' Committee or the Receiver or the Referee of its claims, it would have been able to participate in the 21A examination of the Court-appointed accountant as well as of Mr. Pistelle, President of the petitioner, before the Referee on October 27, 1956 (Supp. R. 251). A representative of the Renegotiation Board could then have attended the various meetings of creditors set forth in that affidavit begin-

ning with October 23, when for the first time a plan of arrangement was presented but rejected (Supp. R. 251). The Board could then have attended the creditors' meeting on October 25, 1956 at which meeting by majority vote the creditors recommended that the plan of arrangement with certain safeguards would be presented (Supp. R. 252), and the Board could then have participated in the creditors' meeting on November 7, 1956 (Supp. R. 255), and could have attended the Court hearing on November 9, 1956 at which hearing the United States Attorney appeared and participated. The Board would thus have been in a position to fully and completely assert its rights and exercise all the remedies provided for by law in its behalf. It certainly would have received the notice of the initial meeting of creditors which was mailed on October 30, 1956. The Department of the Navy concededly received such a notice (R. 82).

In its brief to the Circuit Court, the Government admitted that the Renegotiation Board in October, 1956, was in a position to completely frustrate the proposed plan of reorganization. At pages 42 and 43 of its brief, the Government stated:

> "In this case the renegotiation claims ($650,000 for 1952 and 1953 alone) were greater than all of the remaining unsecured claims against appellant, some $350,000 (Supp. R. 242, R. 17-18, 21-22). Moreover, they were entitled to priority (11 U. S. C. 104; 31 U. S. C. 191). Refusal of the Renegotiation Board to accept the arrangement on behalf of the United States would therefore have blocked confirmation of the arrangement (Supp. R. 83), and required discharge of appellant's petition or involuntary bankruptcy (11 U. S. C. 362, 376). Indeed, the Board could not have been compelled to compromise or extend the renegotiation claims if it had taken part in the proceedings. Sections 337(2) and 361, 11 U. S. C. 737(2), 761; 8 Collier, Bankruptcy, para. 5.33, p. 531."

Curiously, however, the Renegotiation Board never advised the Receiver, the Referee or even the U. S. Attorney in Newark about its claims or its determinations above referred to. The Receiver testified that if the Board had advised him at that time, in October 1956, he would have immediately protected the Government because he was "Government minded" (Supp. R. 74, 79, 83). In spite of the Board's negligence, it is the *debtor* who has been charged with wrongdoing. But there can be no question that the Renegotiation Board was well aware long before October 19 of the fact that the petitioner had not filed its reports for the fiscal years ending 1954 and 1955 in time as is shown by a memorandum from the New York Board dated October 19, 1956 to the Washington office (Exh. 13) calling attention to the fact that the New York Office had no assignments in connection with the subject companies "beyond the 1953 year" (R. 86a). Again, on October 30, 1956, a memorandum prepared in the New York office recited the fact that the New York office was well aware of the fact that the petitioner had not filed renegotiation report forms for the years subsequent to July 31, 1953 (R. 96, 97). That memorandum referred to the fact that the petitioner had been asked to file forms for "all years normally that should have been filed by this time"—meaning 1954 and 1955 as well.

Therefore, it is quite clear that on October 19, 1956 the Regional Board was fully aware of its claim not only for the years 1952 and 1953 but also for the years 1954 and 1955 and also knew of the pendency of the Chapter XI proceedings and the appointment of the Receiver. Yet no step whatsoever was taken by the Board toward promptly advising either the Receiver or the Referee or the Creditors' Committee of the existence of the claims of the Renegotiation Board. Surely, at this point a mere telephone call, letter or telegram to the Receiver or Referee would have been adequate as such notice under the authorities. The Referee would thereupon undoubtedly have held up all further proceedings until the claim of the Government had been included

in the plan or otherwise provided for. See, for example, *In Re Seeley Tube and Box Co.*, 219 F. 2d 389, cert. den. 350 U. S. 821; *In re Weco Equipment Inc.*, 55 F. S. 532, aff'd 145 F. 2d 830; *In re High Point Seating Co.*, 181 F. 2d 747.

Although in October, 1956 the General Accounting office had been requested by the Renegotiation Board to prepare the preliminary and contingent proof of claim, it had not actually prepared such a claim until the end of November. When that claim, dated November 28, 1956, was forwarded to the U. S. Attorney in Newark it was identical in form with the claim already previously filed by the U. S. Attorney on November 9, 1956 prior to the confirmation of the plan (Exhs. 51 and 47). When the U. S. Attorney attempted to file that amended claim the Referee refused to accept it because it was filed too late. The U. S. Attorney had previously been requested to "file objections to any plan which had not taken into consideration the 1954 and 1955 proposed renegotiation claims" (R. 116).

Under the plan, the sum of $262,954.45 had been deposited subject to the order of the Court but the order further provided "that there be no distribution of the funds in the hands of, and deposited with the Receiver, without leave of the Court first obtained, upon notice to the debtors, until all periods for taking appeals have expired, and, if an appeal is taken, until said appeal or appeals have been finally determined, and until the Chapter X proceedings have been dismissed; and in the event the Chapter X proceedings are not dismissed, the moneys deposited hereunder are to be forthwith returned to the person making the deposit." (See last paragraph of Order Confirming Plan of Arrangement—R. 63.) In point of fact, no payment whatsoever out of this fund was actually made until the dismissal of certain appeals on March 14, 1957—many months after the Government's amended claim was rejected.

When the Government's amended claim, which was proffered on November 29, 1956 was rejected by the Referee,

it took none of the steps provided for by the Chapter XI of the Bankruptcy Act. It could have applied to the District Court for an order compelling the Referee to accept the contingent claim. It could have appealed from that order if the relief was denied and sought a stay of the proceedings in the Circuit Court. In addition, it could have sought to set aside the Arrangement at any time within the six (6) months after the date of its confirmation (Title 11 U. S. C. A., Section 786; *Whitford Plastics Co. v. Chase National Bank*, 179 F. 2d 582; *In re Potts*, 142 F. 2d 883, cert. den. 324 U. S. 868; *Hamel v. United States*, 135 F. Supp. 482). As aptly stated by the Trial Court (R. 150):

> "The Court: You believe that was correct, and that excuses the Government from further doing anything in the proceedings, and five years later coming into the Court with the present claims amounting to almost one million dollars? Against the reorganized corporation in which persons who had very little interest in the debtor corporation, or perhaps no interest whatsoever, invested large sums of money in order to put this reorganized corporation on their feet, and have these innocent persons pay for these debts which could have (424) been collected if the Government had been diligent in processing its claim against the debtors in the Bankruptcy Court?"

Had the Government pursued its statutory remedies under Chapter XI under a claim that it had been deceived or defrauded in some way, it would have had to establish that fact. As the case now stands, the Government has been accorded a far more sweeping remedy by these actions which are not only a collateral attack upon the order of confirmation but are being permitted under conditions far less rigorous than those specifically required under sections dealing with Chapter XI proceedings. Under those provisions the Court could not only set aside the order of confirmation and adjudicate the petitioner in the bankruptcy,

but could have modified or altered the arrangement for the purpose of correcting any alleged injustice. However, the Court would not have the power to "materially modify or alter the arrangement *adversely to the interests of any party who did not participate in the fraud* and does not consent to such modification or alteration, *or to the prejudice of any innocent person*, who, for value, subsequent to the confirmation, acquired rights in reliance upon it" (11 U. S. C. § 786). The individual who put up the $262,000 referred to in the plan was certainly "an innocent person" who for value acquired rights in reliance upon the order. Nevertheless, those interests have been jeopardized by these proceedings.

In effect, the arrangement has been unlawfully set aside by this collateral attack. Compare, *Nichols* v. *Alker*, 231 F. 2d 68, cert. den. 352 U. S. 829. The Government had six (6) months within which to have the plan set aside and have the petitioner put into bankruptcy. The order confirming the plan expressly provided for a delay of distribution of the deposited funds under certain circumstances detailed in the order. It is, therefore, clear that the Government intentionally sought to sit by and allow the plan to be carried out after its confirmation to the prejudice of those who put up the money referred to in the plan.

It is submitted that under such circumstances the Government was estopped to assert the claims in suit. The Government was a party to the Chapter XI proceedings and actually collected a renegotiation claim to the extent of $12,000. Its filed claim was broad enough in scope to encompass the present claims as well since the claim was for an "indeterminate amount" and could have been amended or enlarged at any time *even after the confirmation of the plan* by proof of the precise amount owing to the Government. The Government believed, however, that protection of its interests had required the filing of the proposed "amended claim" which was rejected by the Referee and which in content was substantially identical with the claim

previously filed by the Government. Under these circumstances the new investors were lulled into a false sense of security. They justifiably believed that the debtor would only be liable for the claims filed and allowed, since the Government never sought to prove its debt beyond the $12,000 which it received and accepted even after it had full knowledge of all the pertinent facts.

It is submitted that under these circumstances it is unconscionable for the Government to have permitted the consummation of the plan without taking the step which, by its own admission, could have halted its execution and which would have returned to the new investor his $262,000. The facts make out a clear case of estoppel.

The District Court and the Circuit Court both placed emphasis on the fact that one Sidney A. Gutkin, a former counsel of the petitioner in the renegotiation proceedings prior to the filing of the petition under Chapter XI, failed to advise the Renegotiation Board of the filing of the Arrangement petition. This alleged concealment, which Gutkin denies, has apparently been magnified beyond its proper proportions for the following reasons:

The only Government department that the petitioner ever dealt with in connection with the renegotiation proceedings was the Department of the Navy. That Department was advised of the pendency of the Chapter XI proceedings on October 10, 1956 (R. 83). Apparently, the Navy never advised the Renegotiation Board of the pendency of the Chapter XI proceedings. However, on October 19, 1956—still 24 days before the confirmation of the Plan of Reorganization—the Renegotiation Board had actual knowledge of the pendency of the arrangement proceedings. No plan had yet been promulgated. Consequently, whether Gutkin did or did not conceal the proceedings before that date (October 19), makes no difference in law. The only question in this case is whether the knowledge of the Board beginning with October 19th was sufficient under the *Birkett* case to constitute the

kind of knowledge referred to in 11 U. S. C., Section 35, and in the *Birkett* case.

As we shall show, the authorities have held as a matter of law, that such knowledge was sufficient to bring the Government within the rule that a creditor who has such knowledge is discharged pursuant to Section 771 of Chapter XI. Parenthetically, it should be noted that Section 767 of Chapter XI provides that the arrangement and its provisions are binding upon all creditors of the debtor "whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable * * *." If this section is to be given its full import, the question of knowledge would, of course, never arise. In this case, however, it is our contention that the Government had, as a matter of law, adequate knowledge of the pendency of the proceedings in ample time to enable the Government to protect all of its rights. This result it could have accomplished by a simple letter or notice to the Referee or the Receiver. And this step the Renegotiation Board never took.

The scope of the relief accorded to the Government by the District Court and the Court of Appeals below in effect is antithetical to the very purpose of Chapter XI of the Bankruptcy Act. The situation presented here is one in which a creditor with over three weeks' prior actual knowledge of the arrangement proceedings fails to file a claim, waits until the plan of arrangement is confirmed, fails to move to protect its rights in the arrangement proceeding and then, after new investors have poured substantial sums into the corporation, the creditor brings separate actions based upon claims which were in existence prior to the arrangement proceedings and for which it could have sought recovery in the arrangement proceedings. As aptly stated by the Trial Court below:

> "The Court: So a creditor may sit tight or do nothing, and later on say 'I am going to destroy all

this.' The United States Congress has devised this means to protect debtors who are in straitened financial position to come to the Bankruptcy Court, propose an arrangement; then we have somebody come in and help reorganize the corporation, go ahead in business, after this new corporation, the reorganized company is in good financial condition, then jump in? I don't think that's the purpose of Chapter XI of the Bankruptcy Act." (R. 190)

Reasons for Granting the Writ

1. The decision below should be reviewed because it erroneously interprets Section 35 of the Bankruptcy Act and *Birkett* v. *Columbia Bank*, *supra*, and establishes a bad precedent. It establishes a different rule for the Government than for private litigants. The decision below is in conflict with the many cases heretofore decided by the District and Circuit Courts which have held that a creditor who knows of the pendency of bankruptcy proceedings but who fails to file his claim until after confirmation of the plan is barred, even though that creditor was never mentioned in the schedules. In one case a notice of two days was held sufficient. *Gurewitz* v. *Wise*, 122 Me. 444, 120 Atl. 536. In other cases, the period varied. And no case, up to this time, has ever made a different rule for the Government than for any other creditor. See, *In re M. D. Mirsky & Co.*, 32 F. 2d 676, cert. den. 280 U. S. 579, 74 L. Ed. 630; *In re Abrams*, 173 Fed. 430, *Summe* v. *Chapman Dairy Co.*, 238 F. 2d 3, 7; *In re Super Electric Products Corp.*, 200 F. 2d 790—a case in which the Government was the claimant; *Morrison* v. *Vaughn*, 119 App. Div. 184, 104 N. Y. S. 169 (New York Supreme Court).

It is well settled that knowledge of the facts and circumstances which would put a person of ordinary prudence and diligence on inquiry is, in the eyes of the law, equivalent to a knowledge of all facts which reasonable inquiry would disclose. (*American Insurance Company* v. *Lucas*, 38 F. Supp. 896, aff'd 129 2d 143, app. dis. 314 U. S. 575.) If the

Renegotiation Board had, on October 19, 1956, gone over to examine the files in the Bankruptcy Court in Newark it would have had full and complete knowledge of everything that had gone on before that date and would have been in a position to fully participate in the promulgation of any plan, take a position with respect to it and oppose its confirmation, if it was so included. That knowledge—more than 3 weeks before the plan was confirmed—did not come "too late" to deprive the Board of an opportunity to participate in the administration of the affairs of the estate or to deprive it of dividends. It was a knowledge *in time* to avail the Renegotiation Board of all the benefits that the law provided. It was, therefore, clearly the kind of knowledge expressly referred to in 11 U. S. C. Section 35—actual knowledge which made completely effective the discharge in bankruptcy provided for by Section 771 of 11 U. S. C. in Chapter XI.

For this reason the findings of the District Court and the Circuit Court were clearly erroneous because the Renegotiation Board did not even take the simple step of making a telephone call or writing a letter to advise the Referee or the Receiver of its claims between October 19 and November 13, 1956. Surely, if the creditor involved were not a Government agency, the decision reached below would in all probability not have been made. But the statute makes no distinction between the Government and any other creditor for when the Government comes into a Court of Justice it has been held that its rights must be determined upon the same "fixed principles of justice which govern between man and man in like situations" (*Kitter* v. *United States*, 28 F. 2d 265, 267). Courts of bankruptcy are courts of equity. No individual suitor would be permitted to sit by with knowledge of bankruptcy or arrangement proceedings from October 19 until November 13, 1956 and do nothing without incurring the penalty of a discharge of his claim because of that inaction. Similarly, if an individual became a party to an arrangement or similar proceeding, filed a claim and

then attempted to enlarge the claim but was rebuffed in that attempt and took no appeal from the rejection, it surely would be held that it was his duty to have pursued his remedies in the arrangement or bankruptcy proceedings and that he could not collaterally attack the results of that proceeding.

Furthermore, it is difficult to understand how a claimant may submit its claim in part to a Court otherwise having jurisdiction and at the same time reserve a right to disregard that Court's determination as to the balance of his claim which he does not assert or offer under circumstances which result in its rejection and then does nothing to pursue his rights further in the Arrangement proceeding.

2. The District Court as well as the Court of Appeals erroneously applied the provisions of 11 U. S. C. Section 94(e), to the petitioner. That section provides as follows after August 2, 1956:

> "The court shall, in every case instituted under any provisions of this Act, mail or cause to be mailed a copy of the notice of the first meeting of creditors to the district director of internal revenue for the district in which the court is located, and to the Comptroller General of the United States. Whenever the schedules of the bankrupt, or the list of creditors of a bankrupt, or any other papers filed in the case disclose a debt to the United States acting through any department, agency, or instrumentality thereof, (except for any internal revenue obligation payable to the Secretary of the Treasury or his delegate) a notice of the first meeting shall be mailed as well to the head of such department, agency, or instrumentality."

This section applies only to the schedule or list of debts of a bankrupt after adjudication. In any event it is well settled that the section does not apply to Chapter XI pro-

ceedings. It has been held that the "first meeting" under Section 94 can be held only after an adjudication in bankruptcy. *In re Goodrich Manufacturing Company*, 168 F. Supp. 940, aff'd 262 F. 2d 303. This decision was not adverted to either by the District Court or the Court of Appeals. The question does not appear to have been passed upon by this Court.

Furthermore, the only Department of the Government that was in the position of a creditor as to the claims sought in the three actions was the Navy Department (R. 181), and it is undisputed that the Navy Department had notice of the arrangement proceedings between October 10, 1956 and October 16, 1956 (R. 82-84).

3. The Court of Appeals refused to pass upon the question of whether the Renegotiation Board acted beyond the scope of its powers in attempting to apply the Renegotiation Act of 1951 to the petitioner, a Puerto Rican corporation. It is submitted that if the Act itself does not apply to Puerto Rican corporations the determinations of the Board were beyond its jurisdiction and that the validity of those determinations was reviewable in the District Court. The nature of the petitioner's contracts was not involved in determining this issue. The power of the Board over the petitioner depended upon circumstances wholly apart from renegotiable contracts. This raises a pure question of jurisdiction, because the question is whether the Board has any power whatsoever over the petitioner apart from the nature of its contracts. The Circuit Court so held in *Lowell Wool By-Products Co. v. War Contracts Price Adjustment Board*, 192 F. 2d 405, 407. We submit that where an administrative agency such as the Renegotiation Board errs in its assumption of statutory authority the doctrine of exhaustion of administrative remedies does not apply. Surely, it would be useless for the defendant-appellant to be required to wait for a determination by the Tax Court before it could question the statutory power of the Renegotiation Board and the Tax Court itself *vis-à-vis* this petitioner. The acts of the

Board constitute an attempt to confer upon itself power greater than that granted to it by law. That narrow question was therefore within the scope of the District Court's jurisdiction.

4. Another question closely allied to that just mentioned is whether or not the Second Organic Act (48 U. S. C. 734) extended the subsequent Renegotiation Act of 1951 to Puerto Rico. It is submitted that only the Renegotiation Act in effect in 1946 could apply and that Act by its terms was limited to profits made through December 1, 1945. Furthermore, the Renegotiation Act of 1951 was not in any event applicable to Puerto Rico because it was a wholly new statute first enacted by Congress on March 23, 1951. It was not an amendment to any previous Renegotiation statute, since that statute was not in existence on April 14, 1946. It is submitted that it was not applicable to Puerto Rico unless it took on the specific character of an amendment to the Second Organic Act. But the Renegotiation Act did not specify that it applied to Puerto Rico. Nor was the Second Organic Act amended until August 21, 1955. The 1955 amendment to the Second Organic Act became effective on January 1, 1956. Therefore, between May 1, 1946 and January 1, 1956, the effective dates of these two amendments to the Second Organic Act, the Renegotiation Act of 1951 could not apply to Puerto Rico. There is no proof in the record that any profits were actually received by the petitioner subsequent to January 1, 1956. Furthermore, another important question to determine is whether or not the Renegotiation Act was in its very nature a statute "locally inapplicable" to Puerto Rico within the meaning of the Organic Acts and the Puerto Rico Federal Relations Act (48 U. S. C. § 734).

The District Court and Circuit Court decisions deciding whether a Federal Statute is "applicable" or "locally inapplicable" to Puerto Rico evince a policy to apply a statute of the United States to Puerto Rico only where the applica-

tion would confer health and welfare benefits to citizens of Puerto Rico. *Moreno Rios* v. *United States*, 256 F. 2d 68; *Dario Sanchez* v. *United States*, 256 F. 2d 73; *Arbona* v. *Kenton*, 126 F. Supp. 366; *Mitchell* v. *Rubio*, 139 F. Supp. 379. Where the Federal statute would affect matters that the Commonwealth of Puerto Rico is competent to administer, the decisions have held the particular federal statute locally inapplicable. *United States* v. *Rios*, 140 F. Supp. 376; *Trigo Bros. Packing Corp.* v. *Davis*, 159 F. Supp. 841 (reversed on another ground 266 F. 2d 174). Since the one of the major purposes of the Renegotiation Act is to limit income and profits it is apparent that the Commonwealth of Puerto Rico is fully competent to control income and profits of corporations incorporated and doing business there. The application of the Renegotiation Act to corporations incorporated in Puerto Rico would not benefit the health and welfare of the citizens of Puerto Rico.

Furthermore, the application of the Renegotiation Act to corporations incorporated in Puerto Rico is inconsistent with the policy expressed by Congress when it granted to Puerto Rican Corporations a tax exempt status under the internal revenue laws of the United States. Since the intent of Congress in granting tax exempt status to Puerto Rican corporations was to promote and encourage the economic development of Puerto Rico, the application of the Renegotiation Act to Puerto Rican corporations would be antipodal to that policy. The distinction between the Congressional policy and the decision of the Court of Appeals in this case is emphasized by the very absence in the Renegotiation Act of any Congressional intent to apply the Renegotiation Act to the Commonwealth of Puerto Rico.

5. The Renegotiation Board by its regulations exempted Puerto Rico from the application of the Renegotiation Act.

Section 1216(d) of 50 U. S. C. App. (The Renegotiation Act of 1951) gave the Renegotiation Board authority to

promulgate regulations exempting certain contracts or subcontracts from the operation of the Act. 50 U. S. C. App. 1216(d) provides:

> "(d) Permissive exemptions:—
>
> The Board is authorized, in its discretion, to exempt from some or all of the provisions of this title—
>
> (1) any contract or subcontract to be performed outside of the territorial limits of the continental United States or in Alaska."

The Board exercised the authority granted to it by Congress when it promulgated Regulation Section 1455.2, 32 C. F. R. 1455.2(b). This Regulation exempted from the provisions of the Renegotiation Act "all prime contracts and subcontracts for materials or construction, and services connected therewith, or for maintenance, repair or rehabilitation, whenever (i) performance and delivery are to be effected outside of the United States, its territories and possessions, and (ii) the prime contractor or subcontractor is a foreign corporation or a foreign national or is a partnership or joint venture, all the members of which are foreign corporations or foreign nationals." Since the Commonwealth of Puerto Rico "is not now a territory or possession" of the United States (*Mora* v. *Torres*, 113 F. Supp. 309, 313, aff'd 206 F. 2d 377, also *United States* v. *Rios*, 140 F. Supp. 376, 379), and a corporation incorporated in Puerto Rico was not a domestic corporation under The Revenue Act of 1939, § 3797(4), (5), (9), the Renegotiation Board therefore exempted Puerto Rican corporations from the operation of the Renegotiation Act.

The District Court and the Circuit Court below held that the District Court did not have the power to decide the question of whether the Renegotiation Act applied to the petitioner. Relying upon the decisions of this Court in *Macauley* v. *Waterman S. S. Corp.*, 327 U. S. 540, 544 (1946),

and in *Lichter* v. *United States*, 334 U. S. 742, the Circuit Court below in effect held that a question of whether the Renegotiation Act applied to a Puerto Rican corporation is a question of "coverage" as to which the District Court had no power to render a decision. The Circuit Court, we submit, has erroneously interpreted the decisions of this Court in *Macauley*, *supra*, and in *Lichter*, *supra*. Neither of those cases decided the narrow question here presented—whether the District Court had the power to consider the question of whether the Renegotiation Act could be applied to a corporation incorporated in Puerto Rico. This question is not one of "coverage" as that term was employed in *Macauley* and *Lichter* because there "coverage" referred to whether a particular *contract or subcontract* came within the Renegotiation Act.

Obviously, these are important and difficult questions. They involve the construction of important federal statutes. These questions are not only important but recurring. To leave the decision of the Circuit Court in its present state is to sanction the establishment of varying rules of law for the Government and for private citizens in bankruptcy and in Chapter XI proceedings.

It would, indeed, make the administration of such proceedings most impracticable and impossible because in their nature renegotiation claims are not made for a number of years after a fiscal year is concluded. Sometimes a debtor does not even know that it might be subject to such claims. Since the policy of Chapter XI is to give sick corporations a new lease on life, it is contrary to that policy to permit the Board when it has knowledge of the pendency of such proceedings to sit by while they are concluded and the plan executed. For it must be remembered that though the plan may be confirmed swiftly, Chapter XI provides for a period of six months within which the plan may be modified or completely rescinded at the instance of any creditor showing good cause—including the Renegotiation Board.

These are, therefore, important questions of far-reaching magnitude that deserve consideration and review by this Honorable Court.

CONCLUSION

For the reasons set forth it is respectfully submitted that this petition for a writ of certiorari should be granted.

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LOUIS A. TEPPER,
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APPENDIX

Sections of the Bankruptcy Act, 11 U. S. C. 1, et seq.

Section 17, Ch. III, 11 U. S. C. 35(a):

"a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as * * * (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; * * *."

Section 58(e), Ch. VI, 11 U. S. C. 94(e):

"The court shall, in every case instituted under any provisions of this Act, mail or cause to be mailed a copy of the notice of the first meeting of creditors to the district director of internal revenue for the district in which the court is located, and to the Comptroller General of the United States. Whenever the schedules of the bankrupt, or the list of creditors of the bankrupt, or any other papers filed in the case disclose a debt to the United States acting through any department, agency, or instrumentality thereof, (except for any internal revenue obligation payable to the Secretary of the Treasury or his delegate) a notice of the first meeting shall be mailed as well to the head of such department, agency, or instrumentality."

Section 367, Ch. XI, 11 U. S. C. 767:

"Upon confirmation of an arrangement—

(1) the arrangement and its provisions shall be binding upon the debtor, upon any person issuing securities or acquiring property under the arrangement and upon all creditors of the debtor, whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable;"

Section 371, Ch. XI, 11 U. S. C. 771:

"The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, but excluding such debts as, under section 17 of this Act, are not dischargeable."

Sections of the Renegotiation Act of 1951, 50 U. S. C. App. 1211, et seq.

Section 106, 50 U. S. C. App. 1216:

"(d) Permissive Exemptions.—The Board is authorized, in its discretion, to exempt from some or all of the provisions of this title—

(1) any contract or subcontract to be performed outside of the territorial limits of the continental United States or in Alaska."

Section 108, 50 U. S. C. App. 1218:

"Any contractor or subcontractor aggrieved by an order of the Board determining the amount of excessive profits received or accrued by such contractor or subcontractor may—

* * *

file a petition with The Tax Court of the United States for a redetermination thereof. Upon such filing such court shall have exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency.

* * *

The filing of a petition under this section shall operate to stay the execution of the order of the Board under subsection (b) of section 105 only if within ten days after the filing of the petition the petitioner files with the Tax Court a good and sufficient bond, approved by such court, in such amount as may be fixed by the court. Any amount collected

by the United States under an order of the Board in excess of the amount found to be due under a determination of excessive profits by the Tax Court shall be refunded to the contractor or subcontractor with interest thereon at the rate of 4 per centum per annum from the date of collection by the United States to the date of refund."

Second Organic Act, Sec. 9, 39 Stat. 954, as amended, 48 U. S. C. 734 (as it existed prior to the amendment of August 1, 1955):

"United States laws extended to Puerto Rico; internal revenue receipts covered into treasury.

The statutory laws of the United States not locally inapplicable, except as hereinbefore or hereinafter otherwise provided, shall have the same force and effect in Puerto Rico as in the United States, except the internal revenue laws other than those contained in the Philippine Trade Act of 1946: Provided, however, That after May 1, 1946, all taxes collected under the internal revenue laws of the United States on articles produced in Puerto Rico and transported to the United States, or consumed in the island shall be covered into the Treasury of Puerto Rico."

Regulations of the Renegotiation Board, Sec. 1455.2(b), 32 C. F. R. 1455.2(b), provided in pertinent part:

"(a) *Exemption through June 30, 1956.*—Subject to the limitation provided in paragraph (c) of this section, the Board has exempted from the provisions of the act, with respect to amounts received or accrued to and including June 30, 1956, the following:

(1) All prime contracts and subcontracts for materials or construction, and services connected therewith, or for maintenance, repair or rehabilitation, whenever (i) performance and delivery are to be effected outside the United States, its territories and possessions, and (ii) the prime contractor or subcontractor is a foreign corporation or a foreign national or is a partnership or joint venture, all the members of which are foreign corporations or foreign nationals."

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5951.

HERMETIC SEAL PRODUCTS COMPANY, P. R.,
Defendant, Appellant,

v.

UNITED STATES OF AMERICA,
Plaintiff, Appellee.

JUDGMENT

August 30, 1962

This cause came on to be heard on appeal from the United States District Court for the District of Puerto Rico, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is stayed until final determination of the question of the coverage of the Renegotiation Act of 1951, as amended.

By the Court:
/s/ ROGER A. STINCHFIELD,
Clerk.

(cc: Messrs. Tepper and Rose.)

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5952

HERMETIC SEAL PRODUCTS COMPANY, P. R.,
Defendant, Appellant,

v.

UNITED STATES OF AMERICA,
Plaintiff, Appellee.

JUDGMENT

August 30, 1962

This cause came on to be heard on appeal from the United States District Court for the District of Puerto Rico, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is affirmed.

By the Court:
/s/ ROGER A. STINCHFIELD,
Clerk.

(cc: Messrs. Tepper and Rose.)

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5953.

HERMETIC SEAL PRODUCTS COMPANY, P. R.,
Defendant, Appellant,

v.

UNITED STATES OF AMERICA,
Plaintiff, Appellee.

JUDGMENT

August 30, 1962

This cause came on to be heard on appeal from the United States District Court for the District of Puerto Rico, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is affirmed.

By the Court:
/s/ ROGER A. STINCHFIELD,
Clerk.

(cc: Messrs. Tepper and Rose.)

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5951.

HERMETIC SEAL PRODUCTS COMPANY, P. R.,

Defendant, Appellant,

v.

UNITED STATES OF AMERICA,

Plaintiff, Appellee.

ORDER OF COURT

November 13, 1962

It is ordered that the judgment of August 30, 1962, herein be, and the same hereby is, vacated.

By the Court:

/s/ ROGER A. STINCHFIELD,
Clerk.

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5951.

HERMETIC SEAL PRODUCTS COMPANY, P.R.,

Defendant, Appellant,

v.

UNITED STATES OF AMERICA,

Plaintiff, Appellee.

JUDGMENT

November 13, 1962

This cause came on to be heard on appeal from the United States District Court for the District of Puerto Rico, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is affirmed.

By the Court:

/s/ ROGER A. STINCHFIELD,
Clerk.

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5951.

[SAME TITLE]

OPINION OF THE COURT

ON PETITION FOR REHEARING, OR IN THE ALTERNATIVE FOR THE POSTING OF A BOND.

November 13, 1962.

WOODBURY, *Chief Judge*. In this case, No. 5951, we stayed judgment until final determination by the Tax Court of the United States of the question whether the Renegotiation Act of 1951, 65 Stat. 7, 50 U. S. C. App. § 1211 *et seq.* applied to income derived from contracts performed in Puerto Rico by a Puerto Rican corporation. On this petition counsel for the United States calls our attention to the fact that the appellant filed no bond in the Tax Court and that § 108 of the Act, as amended, 70 Stat. 791, 50 U. S. C App. § 1218, provides that the filing of a petition in the Tax Court shall operate to stay the execution of an order of the Renegotiation Board "only" if an adequate bond is filed with the Tax Court within ten days after the petition is filed, that although it appealed to this court the appellant filed no supersedeas bond as required by Rule 73(d), Fed. R. Civ. P. and that § 108, *supra*, provides that any amount collected by the United States in excess of the amount found due by the Tax

Court shall be refunded to the contractor with interest at four per centum from the date of collection to the date of refund.

We think the Government's petition is well grounded. In view of the statutory provisions referred to above there is no need to give the appellant protection it did not request and which was readily available to it by simply filing a bond. Even if we had the statutory power, which is open to question, we are now convinced that our gratuitous favor to the appellant was ill-advised.

An order will be entered vacating the judgment of August 30, 1962, and a new judgment will be entered affirming the judgment of the District Court.